

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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September 18, 2008

### LEGEND

Taxpayer =

Corporation A =

Corporation B =

Corporation C =

Corporation D =

Corporation E =

Corporation F =

Corporation G =

Country W =

Country X =

Country Y =

Business H =

Business I =

Currency M =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Date 1 =

Dear :

This is in response to a letter dated November 2, 2007, submitted on behalf of Taxpayer by its authorized representative, and supplemented by letter dated March 21, 2008, requesting a ruling granting Taxpayer permission to revoke an election made under Treas. Reg. § 1.954-2(g)(4) with respect to Corporation A. The ruling contained in this letter is based upon information and representations submitted by Taxpayer, and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request for ruling, such material is subject to verification upon examination. The information submitted in the request is substantially as set forth below.

#### FACTS

Taxpayer indirectly owned 100 percent of the vote and value of Corporation C, a limited liability company organized in Country Y, and acquired by Taxpayer in Year 1. Corporation C is engaged in Business H. The functional currency of Corporation C is Currency M. An election under Treas. Reg. § 1.954-2(g)(4) was filed in Year 1 with respect to Corporation C.

Taxpayer indirectly owned 100 percent of the vote and value of Corporation D, a limited liability holding company organized in Country Y, and acquired by Taxpayer in Year 1. Corporation D is directly owned by Corporation C. The functional currency of Corporation D is Currency M. An election under Treas. Reg. § 1.954-2(g)(4) was filed in Year 1 with respect to Corporation D.

Taxpayer indirectly owned 100 percent of the vote and value of Corporation F, a limited liability company organized in Country Y, and acquired by Taxpayer in Year 1. Corporation F is engaged in Business H. Corporation F is directly owned by Corporation D and Corporation C. The functional currency of Corporation F is Currency

M. An election under Treas. Reg. § 1.954-2(g)(4) was filed in Year 1 with respect to Corporation F.

Taxpayer indirectly owned 100 percent of the vote and value of Corporation G, a limited liability company organized in Country Y, and acquired by Taxpayer in Year 1. Corporation G is engaged in activities related to Business H and Business I. Corporation G is directly owned by Corporation F and Corporation C. The functional currency of Corporation G is Currency M. An election under Treas. Reg. § 1.954-2(g)(4) was filed in Year 1 with respect to Corporation G.

As part of an internal restructuring in Year 2, Taxpayer organized Corporation A in Country X. Taxpayer directly owns 100 percent of Corporation A, which is a holding company. Corporation A is a controlled foreign corporation (CFC) within the meaning of Internal Revenue Code (Code) section 957(a). The functional currency of Corporation A is the U.S. dollar. Taxpayer contributed 100 percent of Corporation B, a holding company organized in Country W, to Corporation A. The functional currency of Corporation B is the U.S. dollar. Corporations C, D, F and G were transferred to Corporation B from another of Taxpayer's subsidiaries and elected to be disregarded as entities separate from its owner for Federal income tax purposes. Both Corporation A and Corporation B made elections under Treas. Reg. § 1.954-2(g)(4).

In Year 3, Corporation B elected to be disregarded as an entity separate from its owner for Federal income tax purposes.

In Year 4, Taxpayer acquired Corporation E, a Country Y entity, and contributed it to Corporation C. Corporation E is engaged in Business H. The functional currency of Corporation E is Currency M. Corporation E elected to be disregarded as an entity separate from its owner for Federal income tax purposes. On Date 1, Corporation E merged into Corporation C.

Taxpayer represents that it did not make the election under Treas. Reg. § 1.954-2(g)(4) to achieve a tax benefit, but rather for administrative reasons. Because of two significant changes of circumstances that have occurred since the election, Taxpayer now wants to revoke the election for Corporation A. The two changes of circumstances reflect (1) changes in Taxpayer's business operations in Country Y, and (2) changes in Country Y's economic environment.

Specifically, the amount of export sales of Corporations C, F and G denominated in U.S. dollars has increased steadily, despite most of their expenses being incurred in Currency M. For example, since Year 2, the value of Corporation C's U.S. dollar denominated export sales has increased approximately 77 percent. The acquisition and merger into Corporation C of Corporation E in Year 4 also significantly increased the export sales of Corporation C. The denomination of Corporation C's export sales in a

currency other than its functional currency creates a significant economic exposure for Corporation C and significant earnings volatility on Taxpayer's financial statements.

To protect against the adverse economic and financial statement impacts of continuing exchange rate volatility, Taxpayer implemented a hedging strategy for Corporation C in Year 4. The net gains that Corporation C has been realizing on its hedges are foreign personal holding company income due to the election under Treas. Reg. § 1.954-2(g)(4). In the absence of the election, Taxpayer believes the foreign currency gains or losses arising from the export sales would qualify for the Treas. Reg. § 1.954-2(g)(2)(ii)(A) business needs exception from the foreign personal holding company income rules and would not otherwise constitute Subpart F income.

#### RULINGS REQUESTED

Taxpayer requests permission to revoke the election under Treas. Reg. § 1.954-2(g)(4) that was made in Year 2 with respect to Corporation A.

#### LAW

Code section 951(a) requires a United States shareholder of a CFC to include in gross income its pro rata share of the CFC's subpart F income for the taxable year.

Code section 952(a) defines subpart F income to include, among other things, foreign base company income. Code section 954(a) defines foreign base company income to include foreign personal holding company income (FPHCI).

Code section 954(c)(1)(D) provides that FPHCI includes the excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions unless the transaction is directly related to the business needs of the CFC.

Treas. Reg. § 1.954-1(c)(1)(ii) provides generally that a net loss in any category of FPHCI may not reduce income in any other category of FPHCI.

Treas. Reg. § 1.954-2(g)(2)(ii)(A) provides that foreign currency gain or loss directly related to the business needs of the CFC is excluded from FPHCI.

Treas. Reg. § 1.954-2(g)(4)(i) provides that a U.S. shareholder can elect to include in its computation of FPHCI the excess of foreign currency gains over losses or the excess of foreign currency losses over gains attributable to any section 988 transaction (except gains or losses treated as capital gain or loss under section 988(a)(i)(B)). Thus, the general rule of Treas. Reg. § 1.954-1(c)(1)(ii) that net foreign currency losses may not reduce income in any other category of FPHCI would not apply if the CFC has made

this election because the regulations specifically provide that the excess of foreign currency losses over foreign currency gains may reduce other categories of FPHCI.

Treas. Reg. § 1.954-2(g)(4)(iii) provides that an election under Treas. Reg. § 1.954-2(g)(4)(i) is effective for the taxable year of the CFC for which it is made and all subsequent years of such CFC unless revoked by or with the consent of the Commissioner.

Code section 988(a)(1) provides generally that any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss.

Code section 988(b)(1) defines foreign currency gain as any gain from a section 988 transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date.

Code section 988(b)(2) defines foreign currency loss as any loss from a section 988 transaction to the extent such loss does not exceed the loss realized by reason of changes in exchange rates on or after the booking date and before the payment date.

## ANALYSIS

Prior to election under Treas. Reg. § 301.7701-3, for Federal income tax purposes, Corporation A, Corporation B, Corporation C, Corporation D, Corporation F, and Corporation G are CFC's and Taxpayer is a U.S. shareholder of these corporations. Thus, Taxpayer must include in gross income its pro rata share of these CFC's subpart F income for the taxable year.

However, Corporation B, Corporation C, Corporation D, Corporation F, and Corporation G (the subsidiary CFCs) have each elected, in the manner prescribed by Treas. Reg. § 301.7701-3, to be disregarded as an entity separate from its owner for U.S. tax purposes. Corporation A has not elected disregarded entity status under Treas. Reg. § 301.7701-3 and is the sole owner of each of the subsidiary former CFCs. Thus, each of the subsidiary former CFCs are now disregarded as an entities separate from Corporation A. However, since Corporation A has made an election under Treas. Reg. § 1.954-2(g)(4), each of the subsidiary former CFCs remains subject to the terms of the election made by Corporation A. Therefore, in the absence of consent being granted to revoke the Treas. Reg. § 1.954-2(g)(4) election made by Corporation A, Corporation A must include the net foreign currency gains of each of the disregarded entities as FPHCI, without application of any of the exceptions to inclusion of the gains as FPHCI that might otherwise apply.

## RULING

Based upon the facts submitted, permission is granted for Corporation A to revoke its election under Treas. Reg. § 1.954-2(g)(4). The revocation is effective for the taxable year of Corporation A in which this letter ruling is dated. Additionally, Corporation A is prohibited from making a new election under Treas. Reg. § 1.954-2(g)(4) until the sixth taxable year following the taxable year for which the revocation is first effective.

No opinion is expressed about whether the business needs exclusion is satisfied in this case.

This private letter ruling is directed only to the taxpayer who requested it. Code section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter ruling must be attached to any federal income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Taxpayer's representative.

Sincerely,

Phyllis E. Marcus  
Chief, Branch 2  
(International)

cc: